

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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FOR RELEASE ON DELIVERY
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STATEMENT OF
JOSEPH P. NORMILE, ASSOCIATE DIRECTOR
LOGISTICS AND COMMUNICATIONS DIVISION
BEFORE THE
SUBCOMMITTEE ON PUBLIC BUILDINGS
AND GROUNDS
COMMITTEE ON PUBLIC WORKS
AND TRANSPORTATION

HSE 03104

UNITED STATES HOUSE OF REPRESENTATIVES
ON
[CLAIMED DEFAULT ON GENERAL SERVICES
ADMINISTRATION PARTICIPATION
CERTIFICATES, SERIES A THROUGH E]



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Testimony

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE I WELCOME

THIS OPPORTUNITY TO DISCUSS THE EVENTS SURROUNDING THE CLAIMED DEFAULT ON GENERAL SERVICES ADMINISTRATION'S SERIES A-E PARTICIPATION CERTIFICATES. THESE 30-YEAR CERTIFICATES WERE ISSUED UNDER THE PURCHASE CONTRACT AUTHORITY CONTAINED IN PUBLIC LAW 92-313.

PURCHASE CONTRACT AUTHORITY

SECTION 5 OF PUBLIC LAW 92-313, DATED JUNE 16, 1972, AUTHORIZED GSA FOR 3 YEARS TO MAKE PURCHASE CONTRACTS WITH INDEPENDENT CONTRACTORS WHICH WOULD FINANCE AND CONSTRUCT PUBLIC BUILDINGS TO GSA SPECIFICATIONS. GSA WOULD MAKE PERIODIC INSTALLMENT PAYMENTS DURING THE CONTRACT PERIODS TO AMORTIZE CONSTRUCTION AND FINANCING COSTS. AFTER THE CONTRACT PERIOD, NOT TO EXCEED 30 YEARS, TITLE TO THE BUILDINGS WOULD TRANSFER TO THE GOVERNMENT.

IN SUPPORTING THIS LAW GSA ASKED THE CONGRESS IN 1971 FOR PURCHASE CONTRACT AUTHORITY FOR 3 YEARS AS A STOPGAP EXPEDIENT FOR ELIMINATING THE BACKLOG OF CONGRESSIONALLY APPROVED BUT UNFUNDED FEDERAL CONSTRUCTION PROJECTS. AT THAT TIME, GSA LISTED A BACKLOG OF 63 PROJECTS, WITH ESTIMATED CONSTRUCTION COSTS OF ABOUT \$750 MILLION, THAT COULD BE BUILT UNDER PURCHASE CONTRACT ARRANGEMENTS.

UTILIZING THIS LEGISLATION, GSA OBTAINED FINANCING ESTIMATED AT \$1.656 BILLION FOR THE CONSTRUCTION OF 68 PROJECTS.

--FINANCING OF \$697.1 MILLION WAS OBTAINED FOR 29

PROJECTS THROUGH THE SALE OF PARTICIPATION

CERTIFICATES UNDER FOUR SEPARATE TRUST INDENTURES.

--FINANCING COMMITMENTS OF \$534 MILLION WERE
OBTAINED FOR 16 PROJECTS THROUGH BORROWINGS
FROM THE FEDERAL FINANCING BANK.

--FINANCING OF \$425.5 MILLION WAS OBTAINED
FOR 23 PROJECTS FROM PRIVATE INVESTORS.

PARTICIPATION CERTIFICATES

PUBLIC LAW 92-313 AND ITS LEGISLATIVE HISTORY ARE SILENT CONCERNING THE
FINANCING OF PROJECTS WITH PARTICIPATION CERTIFICATES. THE COMPTROLLER GENERAL
HAS RULED, HOWEVER, THAT THIS METHOD IS WITHIN THE FRAMEWORK OF THE LAW.
THE ATTORNEY GENERAL STATED THAT THE PARTICIPATION CERTIFICATES ARE
AUTHORIZED BY LAW AND THAT THE CERTIFICATES ARE GENERAL OBLIGATIONS OF
THE UNITED STATES, BACKED BY ITS FULL FAITH AND CREDIT. SINCE THE
CERTIFICATES WERE GENERAL OBLIGATIONS OF THE UNITED STATES, THE SECURITIES
AND EXCHANGE COMMISSION CONCLUDED THAT THEY WERE EXEMPT SECURITIES UNDER
THE SECURITIES ACT OF 1933 AND THE SECURITIES AND EXCHANGE ACT OF 1934.
THEREFORE WHEN THE CERTIFICATES WERE OFFERED AND SOLD, GSA DID NOT HAVE
TO COMPLY WITH THE SEC REGISTRATION REQUIREMENTS.

GSA ISSUED \$697.1 MILLION OF PARTICIPATION CERTIFICATES UNDER FOUR
TRUST INDENTURES. ABOUT \$652.77 MILLION OF CERTIFICATES WERE OUTSTANDING
AS OF SEPTEMBER 30, 1978.

--THE FIRST INDENTURE, DATED NOVEMBER 6, 1972,

COVERED SERIES A THROUGH E FOR A TOTAL OF

\$196,500,000.

--THE SECOND INDENTURE, DATED DECEMBER 18, 1972,

WAS FOR SERIES F, IN THE AMOUNT OF \$200,000,000.

--THE THIRD INDENTURE, DATED MARCH 21, 1973, WAS

FOR SERIES G IN THE AMOUNT OF \$126,000,000.

--THE FOURTH INDENTURE DATED AUGUST 1, 1973, WAS

FOR SERIES H. THIS INDENTURE WITH SUPPLEMENTS

THERETO (I AND J) COVERED \$174,610,000.

SERIES A THROUGH E

PARTICIPATION CERTIFICATES, SERIES A THROUGH E ARE COVERED BY A TRUST INDENTURE BETWEEN GSA AND THE TRUSTEE, FIRST NATIONAL CITY BANK. UNDER THE PROVISIONS OF THE INDENTURE, THE BANK ACTS IN A DUAL ROLE (1) AS A TRUSTEE FOR THE CERTIFICATE HOLDERS AND (2) AS PAYING AGENT FOR GSA. THE BANK, ACTING AS TRUSTEE FOR THE CERTIFICATE HOLDERS, HOLDS THE PROCEEDS FROM THE SALE OF CERTIFICATES IN TRUST FOR DISBURSEMENT UNDER DIRECTION OF GSA. THE PROCEEDS WERE TO BE HELD INITIALLY IN A CONSTRUCTION FUND AND A DEBT SERVICE FUND AND UTILIZED FOR PAYMENT OF PROJECT CONSTRUCTION, INTEREST DURING CONSTRUCTION, AND OTHER COSTS, SPECIFIED IN THE INDENTURE. WHEN CERTAIN EVENTS OCCURED AS DESCRIBED IN THE INDENTURE BALANCES REMAINING IN THE CONSTRUCTION FUND WERE TO BE TRANSFERRED TO A COMPLETION FUND OR TO A PURCHASE FUND.

THE BANK, ACTING FOR GSA, PAYS INTEREST AND PRINCIPAL TO THE CERTIFICATE HOLDERS AND COSTS AND EXPENSES TO CONTRACTORS FOR THE CONSTRUCTION OF FIVE PROJECTS.

AS SET FORTH IN THE INDENTURE, THE CERTIFICATES ARE SUBJECT TO OPTIONAL AND MANDATORY REDEMPTION. UNDER A MANDATORY SINKING FUND, A PERCENTAGE OF THE CERTIFICATES IS TO BE REDEEMED ANNUALLY STARTING NOVEMBER 1, 1976.

THE ANNUAL PERCENTAGES FOR 1976, 1977, AND 1978 WERE 1.25, 1.50 AND 1.50, RESPECTIVELY. THE MANDATORY ANNUAL PERCENTAGE TO BE REDEEMED IS NOT BASED ON THE AMOUNT OF THE ISSUE, \$196,500,000, BUT ON THE "PRINCIPAL AMOUNT OF THE PURCHASE PRICE." THIS TERM IS DEFINED IN THE INDENTURE TO MEAN THE TOTAL AMOUNT PAID BY THE TRUSTEE FROM THE CONSTRUCTION, AND DEBT SERVICE FUNDS (CONSTRUCTION COSTS, INTEREST DURING CONSTRUCTION, AND OTHER COSTS) AND ANY AMOUNTS TRANSFERRED TO THE COMPLETION FUND. THE PRINCIPAL AMOUNT OF THE PURCHASE PRICE FOR SERIES A THROUGH E IS \$211,800,716.47

UNDER CERTAIN CIRCUMSTANCES GSA WAS ENTITLED TO CREDITS AGAINST MANDATORY REDEMPTION AMOUNTS FOR CERTIFICATES PURCHASED ON THE OPEN MARKET. TO MEET THE MANDATORY SINKING FUND REDEMPTION ON NOVEMBER 1, 1976, CERTIFICATES AMOUNTING TO \$1,255,000 WERE CALLED AND REDEEMED AT PAR. GSA ALSO TOOK A CREDIT FOR \$1,200,000 FOR MARKET PURCHASES MADE IN 1976--A COMBINED REDEMPTION OF \$2,455,000. ON NOVEMBER 1, 1977, \$2,950,000 OF CERTIFICATES WERE CALLED FOR REDEMPTION. WITH RESPECT TO THE MANDATORY SCHEDULED REDEMPTION OF NOVEMBER 1, 1978, NO CALL WAS ISSUED. PRIOR PURCHASES, MADE BY THE TRUSTEE ON THE OPEN MARKET, WERE USED AS A CREDIT AGAINST THE NOVEMBER 1, 1978, INSTALLMENT.

ON JANUARY 2, 1979, THE PURITAN FUND, INC., OWNER OF \$17,640,000 OF CERTIFICATES, NOTIFIED THE TRUSTEE AND GSA THAT THE GOVERNMENT FAILED TO PAY THE MANDATORY SINKING FUND INSTALLMENT DUE ON NOVEMBER 1, 1978, AND THAT THE CREDIT CLAIMED FOR PRIOR PURCHASES COULD NOT BE APPLIED AGAINST THE NOVEMBER 1, 1978, MANDATORY SINKING FUND INSTALLMENT. PURITAN CONTENDED THAT THE PURCHASES HAD TO BE CLAIMED AS A CREDIT AGAINST THE "NEXT" SINKING FUND INSTALLMENT OCCURRING MORE THAN 45 DAYS

AFTER SUCH PURCHASE AND CANCELLATION. ACCORDING TO THE PURITAN FUND, THE CREDIT COULD HAVE APPLIED TO THE NEXT INSTALLMENT OF NOVEMBER 1, 1977, BUT NOT TO THE NOVEMBER 1, 1978, INSTALLMENT.

ON JANUARY 29, 1979, THE TRUSTEE NOTIFIED THE HOLDERS OF PARTICIPATION CERTIFICATES THAT THE GOVERNMENT WAS NOT PROPERLY ENTITLED TO A CREDIT AGAINST THE MANDATORY INSTALLMENT DUE OCTOBER 31, 1978, FOR CERTIFICATES PREVIOUSLY PURCHASED BY THE TRUSTEE. THE TRUSTEE ALSO INDICATED THAT THE MANDATORY REDEMPTIONS IN 1976 WERE SHORT BY \$190,000 AND IN 1977 BY \$225,000. THE TRUSTEE STATED EACH FAILURE TO PAY THE INSTALLMENTS IN CASE BECAME AN EVENT OF DEFAULT AS DEFINED IN THE INDENTURE.

AS PROVIDED IN THE INDENTURE, IN THE EVENT OF DEFAULT THE TRUSTEE OR HOLDERS OF 25 PERCENT OF THE OUTSTANDING CERTIFICATES MAY, BY NOTICE IN WRITING TO THE CONTRACTING OFFICER, DECLARE THE ENTIRE OUTSTANDING CERTIFICATES DUE AND PAYABLE IMMEDIATELY.

THE TRUSTEE DID NOT DECLARE THE ENTIRE OUTSTANDING PRINCIPAL AMOUNT OF THE CERTIFICATES DUE AND PAYABLE IMMEDIATELY, BUT INDICATED THAT HE WOULD EVALUATE INFORMATION TO DETERMINE THE APPROPRIATE COURSE OF ACTION. HE DID STATE THAT THE GOVERNMENT DEPOSITED SUFFICIENT CASH WITH THE TRUSTEE TO MAKE NECESSARY MANDATORY REDEMPTIONS TO CURE THE DEFAULT. IN THIS CONNECTION, GSA TRANSFERRED \$4.1 MILLION TO THE TRUSTEE ON JANUARY 19, AND 26, 1979.

IT IS GSA'S POSITION THAT BY VIRTUE OF THE PAYMENTS TO THE TRUSTEE, THE GOVERNMENT CURED THE CLAIMED "EVENT OF DEFAULT", AND THEREFORE THE RIGHTS AND REMEDIES UNDER THE INDENTURE WHICH FOLLOW UPON THE HAPPENING OF AN EVENT OF DEFAULT ARE NO LONGER APPLICABLE.

ON JANUARY 31, 1979, THE TRUSTEE ISSUED A REDEMPTION NOTICE FOR THE REDEMPTION OF \$3,595,000 PRINCIPAL AMOUNT OF PARTICIPATION CERTIFICATES ON MARCH 2, 1979, AS FOLLOWS:

NOVEMBER 1, 1976 ENTIRE CALL	\$3,150,000
NOVEMBER 1, 1977 SHORTAGE	225,000
NOVEMBER 1, 1976 SHORTAGE	<u>190,000</u>
	<u>\$3,595,000</u>

THE SHORTAGE IN 1976 OF \$190,000 IN THE ANNUAL REDEMPTION INSTALLMENT AND IN 1977 OF \$225,000 WAS DUE TO AN ERROR IN COMPUTING THE MANDATORY REDEMPTION AMOUNT. THE COMPUTATION WAS BASED ON A PERCENTAGE OF THE FACE AMOUNT OF THE CERTIFICATES OF \$196,500,000 RATHER THAN BASED ON A PERCENTAGE OF THE PRINCIPAL AMOUNT OF THE PURCHASE PRICE OF \$211,800,716.47.

IN VIEW OF THE DELAY IN REDEEMING CERTIFICATES, THE GOVERNMENT AGREED TO PAY, AS PART OF THE REDEMPTION PRICE, INTEREST ON THE \$3,595,000 OF CERTIFICATES AT 9.3 PERCENT FROM NOVEMBER 1, 1978, TO THE REDEMPTION DATE. THE INTEREST RATE ON SERIES A THROUGH E AVERAGES ABOUT 7.28 PERCENT--A 2 PERCENT DIFFERENTIAL. THE 9.3 PERCENT RATE FOR THE SHORTFALL PERIOD WAS BASED ON THE YIELD FOR MARKETABLE TREASURY SECURITIES WITH COMPARABLE PERIODS OF MATURITY.

SINCE THE SERIES A THROUGH E CERTIFICATES CARRY INTEREST RATES ABOUT 2 PERCENT BELOW THE TREASURY RATE AND TRADE AT SIZABLE DISCOUNTS BELOW PAR, REDEMPTION OF THE ENTIRE ISSUE AT PAR WOULD BE BENEFICIAL TO THE CERTIFICATE HOLDERS. HOWEVER, IT WOULD COST THE GOVERNMENT AN EXTRA \$3.75 MILLION THE FIRST YEAR IN ADDITIONAL INTEREST COSTS ON THE \$187,825,000 OF OUTSTANDING CERTIFICATES.

MR. CHAIRMAN, THAT CONCLUDES OUR COMMENTS ON SERIES A THROUGH E. WE ARE NOT IN A POSITION AT THIS TIME TO COMMENT ON THE CERTIFICATES ISSUED PURSUANT TO INDENTURES F, G AND H.